

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 2 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

(Note to Auditor: We strongly recommend that, as part of expenditure testing, the auditor review the redeemed warrants of the school district at the County offices. The redeemed warrants are typically maintained in the Clerk and Recorder's office. Several embezzlements have been detected when auditors discovered that the name on the redeemed warrant did not match the duplicate warrant and accounting records maintained by the school district.)

HOLIDAY BENEFITS

1. Compliance Requirements:

- Only the following school holidays are permitted: (Section 20-1-305, MCA)
 - (a) New Year's Day (January 1)
 - (b) Memorial Day (last Monday in May)
 - (c) Independence Day (July 4)
 - (d) Labor Day (first Monday in September)
 - (e) Thanksgiving Day (fourth Thursday in November)
 - (f) Christmas Day (December 25)
 - (g) State and national election days when the school building is used as a polling place and the conduct of school would interfere with the election process. When these holidays fall on a Saturday or Sunday, the preceding Friday or the succeeding Monday shall not be a school holiday.
- Non-teaching employees are entitled to the above mentioned school holidays rather than the legal holidays specified in Section 1-1-216, MCA. (A.G.O. No. 150, Vol. 37)
- A school district may have negotiated agreements or policies that specify other days off in addition to the holidays enumerated above.

Suggested Audit Procedure:

- Determine, by reviewing selected school district records, that holidays were restricted, for teaching and non-teaching personnel alike, to those named above or as provided in a negotiated agreement or in board policy.

RETIREMENT SYSTEMS

2. Compliance Requirements:

- Except as otherwise provided in Section 19-20-302, MCA, the following school district employees must be active members of the Teacher's Retirement System (TRS): (Section 19-20-302(1), MCA)
 - a. teachers, principals, or district superintendents, as defined in Section 20-1-101, MCA; and

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 3 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued

2. Compliance Requirements - continued:

- b. speech-language pathologists, school nurses, school psychologists, or any person employed in a teaching capacity by a special education cooperative or a school district.
- A substitute teacher or a part-time teacher's aide shall:
 - a. file an irrevocable written election whether to become an active member of TRS on the first day of employment, OR
 - b. is required to become an active member of TRS after completing 210 hours of employment in any fiscal year. (Section 19-20-302(4)(a), MCA)
- A person employed as a substitute teacher on July 1, 1999, who has not elected to become a member by that date shall file an irrevocable written election as above on the first day of employment as a substitute in the next school year after July 1, 1999. Also, a person employed as a part-time teacher's aide on July 1, 2001, who is not a member of the retirement system shall file an irrevocable written election as above on the first day of employment as a part-time teacher's aide after July 1, 2001. (Section 19-20-302(4)(c) & (4)(d), MCA)
- The school district shall give written notification to a substitute teacher or, to a part-time teacher's aide on the first day of employment of the option to elect membership in TRS. If these individuals decline to elect membership during the election period, they shall file a written statement with the district, waiving membership, and the district shall retain the statement. (Section 19-20-302(4)(e) & (4)(f), MCA)
- The school district may also provide coverage under the Public Employees Retirement System (PERS) for full-time non-teaching employees. Non-teaching employees who work no more than 960 hours in any fiscal year are also eligible to join PERS. (Sections 19-3-411, 19-3-201, and 19-3-412, MCA)

Suggested Audit Procedures:

- Test payroll records and determine that there have been TRS or PERS contributions made by the school district and the employee for all employees that are required to belong to TRS or PERS or who are eligible and have elected to join one of the retirement systems.
- Determine that the school district has provided written notification to all substitute teachers and part-time teacher's aides, on the first day of their employment, that they have an option to elect membership in TRS.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 4 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued

Suggested Audit Procedures - continued:

- If substitute teachers and part-time teacher's aides decline membership during the election period, determine that the school district has written statements to that effect on file. Verify that these individuals become members if they work the qualifying 210 hours during the fiscal year.

3. Compliance Requirement:

- The employee and/or the employer must pay withholding and/or employer payments for:
 1. Public Employees Retirement System (PERS) – The contribution is calculated on the employee's gross compensation as follows:

Effective Date	Employer Contribution § 19-3-316, MCA	Employee Contribution § 19-3-315, MCA	State Contribution § 19-3-319, MCA
7/1/1999	6.8%	6.9%	.1%
	(6.9% less State contribution of .1% - §19-3-319)		

2. Teachers Retirement System (TRS) - The contribution is calculated on the employee's gross compensation as follows:

Effective Date	Employer Contribution §19-20-605	Employee Contribution § 19-20-602, MCA	State Contribution § 19-20-604, MCA
7/1/1999	7.47%	7.15%	.11%

Suggested Audit Procedure:

- Test selected payroll reports and records to determine if the required amounts are withheld from the employees' salaries and/or paid by the employer for the purposes listed above.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 5 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

4. Compliance Requirements: (Applicable to PERS)

- For purposes of retirement systems, "compensation" means remuneration paid ... before any pretax deductions allowed by state or federal law are made. (Sections 19-3-108(1) (PERS); 19-7-101(1)(SRS); 19-9-104(1)(MPORS) and 19-13-104(2)(FURS), MCA) (**Note:** In addition, Section 19-3-108(1), pertaining to PERS, specifically states that compensation does not include contributions to group insurance, such as that provided under 2-18-701 through 2-18-704.)
- Pre-tax deductions, including elective contributions under an IRC section 125 (Section 125) cafeteria plan, may be considered compensation for purposes of these retirement systems, but only if the following conditions are met:
 - If an employer increases a member's compensation to account for health, dental, vision, life or disability costs, the amount of the increase can be included in compensation for retirement system purposes only if the employer includes that amount, to the extent required by applicable federal and state law, in its calculation of the member's compensation for all purposes, including but not limited to federal and state income taxes, FICA, unemployment insurance, overtime, shift differentials, workers' compensation, and benefits based on compensation, such as life or disability benefits based on a multiple or percentage of annual pay.
 - The cafeteria plan must be a bona fide cafeteria plan that is operated in compliance with the following requirements of Section 125 (See details at MPERA policy website, below):
 1. The written plan document must incorporate all Section 125 operating rules and regulations and must be formally adopted before the first day of the first plan year.
 2. All participants in the plan must be employees – self-employed individuals and independent contractors cannot participate.
 3. The plan must allow participants to choose among 2 or more benefits consisting of cash and qualified benefits. A plan that does not include the option of receiving cash instead of a qualified benefit is not eligible.
 4. Employees must be allowed to choose between the qualified benefit and cash either through an affirmative election, a mandatory election, or a waiver of participation.
 5. The cafeteria plan may offer only qualified benefits as defined under Section 125(f).
 6. Elections made under the cafeteria plan must be irrevocable for an entire plan year, except to the extent mid-year election changes are permitted under Section 125.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 6 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

RETIREMENT SYSTEMS - continued:

4. Compliance Requirements - continued:

7. The cafeteria plan must satisfy the nondiscrimination requirements of Section 125.

(Montana Public Employees' Retirement Board – Policy No. BOARD Admin 05, effective date of 12/9/2005 – see <http://mpera.mt.gov/Policies.asp>) (**NOTE:** This policy, clarifying the definition of compensation for retirement system purposes, was approved by the Board on 12/9/2005. **A participating employer must demonstrate compliance with this policy effective with the next “125 plan” year that follows 8/25/05.**)

Suggested Audit Procedures:

- Review the employer's Section 125 cafeteria plan, including the elective deferrals that are offered, and ensure that it meets the above requirements.
- For selected individuals that are members of the above retirement systems, including one or two individuals with management positions, determine the compensation (total wages) reported to the applicable retirement system. (**NOTE:** Monthly reports to the retirement systems include a listing of individuals, along with reported compensation and contributions made.) Compare this compensation to the total wages, salaries, etc. reported for worker's compensation or state unemployment purposes. If differences exist, perform appropriate follow-up procedures to determine the cause of the differences. (**NOTE:** Differing due dates for worker's compensation and state unemployment reports may result in differences that will need to be reconciled.)

ANNUAL VACATION LEAVE

5. Compliance Requirements:

- Noncertified permanent full-time employees earn annual vacation leave credits based on total years of employment, as follows: (Section 2-18-612, MCA)
 - a. 1 day through 10 years - 15 working days per year
 - b. 10 years through 15 years - 18 working days per year
 - c. 15 years through 20 years - 21 working days per year
 - d. 20 years on - 24 working days per year.
- Noncertified full-time employees earn vacation leave from the first day of employment, but must be continuously employed for six calendar months before they are eligible to take any vacation leave. (Section 2-18-611(1), MCA)
- No vacation leave shall accrue while a noncertified employee is in a leave-without-pay status. (Section 2-18-611(4), MCA)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 7 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ANNUAL VACATION LEAVE - continued

5. Compliance Requirements - continued:

- Permanent part-time noncertified employees receive prorated annual vacation leave credits if they have worked for the qualifying period. (Section 2-18-612(3), MCA)

Suggested Audit Procedure:

- Test the vacation leave records for selected noncertified employees to determine if the employees are earning the appropriate number of vacation days in accordance with the above statutory requirements.

To calculate vacation leave credits for a pay period, multiply the total number hours paid (regular, holiday, vacation, and sick leave hours, excluding overtime hours) by the rate appropriate for the total years of employment (i.e., 15, 18, 21, or 24):

15 days X 8 hrs = 120 hrs/2080 hrs = .058 X hours paid

18 days X 8 hrs = 144 hrs/2080 hrs = .069 X hours paid

21 days X 8 hrs = 168 hrs/2080 hrs = .081 X hours paid

24 days X 8 hrs = 192 hrs/2080 hrs = .092 X hours paid

(Section 5-1740 of the School Accounting Manual)

6. Compliance Requirements:

- Noncertified employees may accumulate annual vacation leave to a total not to exceed two times the maximum number of days earned annually as of the end of the first pay period of the next calendar year. Excess vacation time is forfeited if not taken within 90 calendar days from the last day of the calendar year in which the excess was accrued. (Section 2-18-617, MCA)

(Note: See Compliance Requirement No. 5 above for the annual vacation leave credits that are earned per statute.)

- If an employee (noncertified) makes a reasonable written request to use excess vacation leave before the excess vacation leave must be forfeited and the local government denies the request, the excess vacation leave is not forfeited and the local government shall ensure that the employee may use the excess vacation leave before the end of the calendar year in which the leave would have been forfeited. (Section 2-18-617, MCA)

Suggested Audit Procedures:

- Test the vacation leave records for selected noncertified employees to determine that vacation leave balances of employees did not exceed the maximum allowed by statute as of the end of the first pay period of the next calendar year.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 8 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

ANNUAL VACATION LEAVE - continued

Suggested Audit Procedures - continued:

- If the vacation leave balance was in excess of the maximum allowed, determine that the excess was either used within 90 days from the last day of the calendar year in which the excess was accrued, or forfeited unless the employee made a reasonable request to use the leave and the request was denied.

7. Compliance Requirements:

- Noncertified employees will receive pay for vacation leave not used if the employee terminates employment, has worked for the 6 month qualifying period, and has not terminated employment for a reason reflecting discredit on the employee. (Section 2-18-617(2), MCA)
- Section 2-18-617, MCA, does not prohibit a school district from providing cash compensation for unused vacation leave in lieu of the accumulation of the leave, either through a collective bargaining agreement or, in the absence of a collective bargaining agreement, through a policy. (Section 2-18-617(4), MCA)
(Note: This type of policy should preferably be in writing.)
- Seasonal (noncertified) employees may receive lump-sum settlements for accrued credits at the end of each season or the credits may be carried over to the next season.

(Note: The State has adopted this interpretation of Section 2-18-617, MCA, by adopting an administrative rule under the authority of Section 2-18-604, MCA (ARM 2.21.221). Section 2-18-604, MCA, also gives school districts the authority to promulgate rules to administer the vacation, sick, military, and jury duty provisions in Title 2, Chapter 18, Part 6, MCA. Therefore, a school district could adopt a similar interpretation for seasonal (noncertified) employees.)

Suggested Audit Procedure:

- As part of expenditure testing for personal services, determine that any payments for unused vacation leave were only made if the employee terminated employment with the district, if the employee was a seasonal employee accepting a lump-sum payment, or if the school district provided for such cash compensation either through a collective bargaining agreement or through the school district's official policy.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 9 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SICK LEAVE

8. Compliance Requirements:

- Permanent full-time employees (noncertified) earn 12 days of sick leave per year and there is no restriction on the number of hours that may be accumulated. (Section 2-18-618(1), MCA)
- Employees (noncertified) earn sick leave from the first day of employment, but must be continuously employed for 90 days before they are eligible to use any sick leave. (Section 2-18-618(1), MCA)
- An employee (noncertified) may not earn sick leave while in a leave-without-pay status. (Section 2-18-618(2), MCA)
- Permanent part-time employees (noncertified) receive prorated sick leave credits if they have worked for the qualifying period of 90 days. (Section 2-18-618(3), MCA)
- Full-time temporary and seasonal employees (noncertified) are entitled to sick leave benefits if they have worked the qualifying period of 90 days. (Section 2-18-618(4), MCA)
- A short-term worker (noncertified) may not earn sick leave credits. A short-term worker is a person who is hired by a district for an hourly wage; may not work for the district for more than 90 days in a continuous 12-month period; is not eligible for permanent status; and may not be hired into another position by the agency without a competitive selection process. (Section 2-18-101 and 2-18-618(5), MCA)

Suggested Audit Procedure

- Test the sick leave records for selected noncertified employees to determine that the employees are earning the appropriate number of sick leave credits based on their employment status and length of employment.

To calculate sick leave credits for a pay period, multiply the total number hours paid (regular, holiday, vacation, and sick leave hours, excluding overtime hours) by the following rate:

12 days X 8 hrs = 96 hrs/2080 hrs = .046 X hours paid
(Section 5-1740 of the School Accounting Manual)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 10 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SICK LEAVE - continued

9. Compliance Requirements:

- Except as discussed in Compliance Requirement No. 16 below, upon termination of employment, a noncertified employee is entitled to a lump-sum payment equal to $\frac{1}{4}$ of the pay attributed to the accumulated sick leave. The pay must be computed on the basis of the employee's salary or wage at the time of termination. (Section 2-18-618(6), MCA)
- A noncertified employee may not be paid upon termination for any remaining sick leave credits that were accrued prior to July 1, 1971. (Section 2-18-618(6), MCA)
- For noncertified employees, abuse of sick leave is cause for dismissal and forfeiture of the lump-sum payments for accumulated sick leave. (Section 2-18-618(8), MCA)

Suggested Audit Procedures:

- As part of expenditure testing for personal services, determine that any payments to noncertified employees for unused sick leave were only made if the employee terminated employment with the school district.
- Test selected payments for unused sick leave to determine that the noncertified employee was paid an amount equal to $\frac{1}{4}$ of the pay attributed to the accumulated sick leave earned after July 1, 1971, based upon the employee's salary or wage at the time of termination.

10. Compliance Requirement:

- School teachers, principals, and superintendents should have contracts with the school district that specify the vacation and sick leave benefits.

Suggested Audit Procedure:

- Test sick leave and vacation records for selected teaching personnel, and determine if the district adheres to the benefits set out in those contracts.

11. Compliance Requirement:

- A school district may establish and administer, through local rule, a sick leave fund into which its non-certified employees may contribute a portion of their accumulated sick leave. (Section 2-18-618(10), MCA)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 11 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

SICK LEAVE - continued

Suggested Audit Procedure:

- If the district has established a sick leave fund for its non-certified employees, obtain a copy of the rules adopted for the fund, and determine that the fund is being administered accordingly.

JURY/WITNESS DUTY AND MILITARY LEAVE

12. Compliance Requirements:

- Any employee that serves as a juror or is subpoenaed to serve as a witness must either:
 - a. pay to the district the juror or witness fees and receive his or her normal compensation from the school district, or
 - b. charge the time spent as annual vacation leave and retain the juror/witness fees. (Sections 2-18-604 and 2-18-619, MCA)

(Note: Either way, the employee is not required to remit any expense or mileage allowance paid by the court.)

- An employee (certified or noncertified) who is a member of the organized militia of Montana or of the reserve corps or military forces of the United States, and who has been an employee for a period of 6 months, shall be given leave of absence with pay for a period of time not to exceed 15 working days in a calendar year for attending military services. This leave may not be charged against the employee's annual vacation time. (AGO #35, Volume 36; and Section 10-1-1009, MCA)

Suggested Audit Procedures:

- If it is determined during the audit that an employee served as a witness or juror, review the employee's payroll records to determine if it was recorded as a vacation day. If not, determine that the amount of the juror or witness fee paid to the employee was paid to the district.
- Through inquiry and observation, determine if any employee was absent during the audit period for military training. If so, verify that the district did not charge this time against the employee's annual vacation time.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 12 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

COMPENSATION OF OFFICIALS AND EMPLOYEES

13. Compliance Requirements:

- Trustees shall not receive compensation for their services as trustees, except that the secretary of the trustees of a high school district operating a county high school or the secretary of a joint board of trustees may be compensated for his services as the secretary. (Section 20-3-311, MCA) **(Note: A trustee that resides over 3 miles from the trustees' meeting place shall be reimbursed at the rate as provided in 2-18-503 for every mile necessarily traveled in attending regular and special meetings, and all trustees shall be similarly reimbursed for meetings called by the county superintendent. See SD-4 for compliance requirement related to travel expenses.)**
- Each teacher or specialist must be employed under written contract, and each contract of employment must be authorized by a resolution of the trustees. (Section 20-4-201, MCA)
- Each district superintendent or county high school principal must be employed under written contract, and each contract must be authorized by a resolution of the trustees. **(Note: An individual holding a class 3 teacher certificate with a district superintendent endorsement may be employed as the county high school principal in lieu of a district superintendent.)** The contract must be for a term of not more than 3 years, and after the second successive contract, the contract is considered to be renewed for a further term of 1 year from year to year. (Section 20-4-401, MCA)
- If any appropriation item of a school district's final budget provides for the payment of wages or salary to more than one person, the district shall attach to the budget a separate listing of each position of employment, with the budgeted amount of compensation for each position. (Section 20-9-132, MCA)

Suggested Audit Procedures:

- As part of expenditure testing for personal services (payroll), determine that salaries for school district teachers, specialists, principals and superintendents were established by contract and authorized by resolution of the trustees. Verify that amounts paid agree to the contract amounts.
- Through observation and inquiry, and during the course of the audit, verify that salaries or wages were not paid to trustees.
- Compare selected district employees' wages to amounts listed on the itemized final budget to verify that amounts agree.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 13 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

OVERTIME

14. Compliance Requirements:

- Except as noted below, an employer may not employ any employee (noncertified) for a workweek longer than 40 hours unless the employee receives compensation for employment in excess of 40 hours in a workweek at a rate of not less than 1 ½ times the hourly wage rate at which the employee is employed. (Section 39-3-405, MCA)
(Note: This provision generally agrees to the overtime provisions of the Federal Fair Labor Standards Act (FLSA), which covers virtually all local government employees. (29 CFR §553.3)
- The overtime provisions of Section 39-3-405 do not apply to the following: (Section 39-3-406, MCA):
 1. An individual employed in a bona fide executive, administrative, or professional capacity, as these terms are defined in Administrative Rules of Montana 24.16.201 through 24.16.205. **(Note: These ARMS can be accessed through the Secretary of States Web page at <http://sos.mt.gov/>, or the direct link is <http://arm.sos.mt.gov/>). (Section 39-3-406(j), MCA)**
 2. A school district employee employed, at the employee's option, on an occasional or sporadic basis in a capacity other than the employee's regular occupation. Only the hours that the employee works in this occasional or sporadic capacity may be excluded from the calculation of hours to determine overtime compensation. (Section 39-3-406(2)(x), MCA)
- School district employees who are covered by the FLSA may reach agreement with their employers to receive compensatory time in lieu of cash overtime. Compensatory time in lieu of cash must be at the rate of not less than 1 ½ hours of compensatory time for each hour of overtime worked. (29 CFR §553.20; A.G.O. No. 58, Vol. 41)
(Note: State and federal law do not require the local government to make the accrual or use of compensatory time available to "exempt" employees (i.e., individuals employed in a bona fide executive, administrative, or professional capacity as discussed above). However, the local government may establish a policy of permitting compensatory time to be earned by "exempt employees" on an "hour-for-hour" basis for time in a pay status in excess of 40 hours in a workweek. Accrued time may be taken as approved time off at a later date.)
 1. As a condition for use of compensatory time in lieu of overtime payment in cash, an agreement or understanding must be reached prior to the performance of work. A copy of this agreement or understanding should be kept on file, or if not in writing, a record of its existence should be kept. (29 CFR §553.23(a) & .50)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 14 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

OVERTIME - continued

14. Compliance Requirements - continued:

2. Generally, no more than 240 hours of compensatory time may be accrued. This 240 hour limit is based on 160 hours actual overtime worked. Any additional overtime hours worked over this limit must be paid in cash overtime. (29 CFR §553.21 & .22)
3. Any employee who has accrued compensatory time and requested use of it must be permitted to use such time off within a reasonable period after making the request, if such use does not unduly disrupt school district operations. An employee must not be coerced to accept more compensatory time than an employer can realistically expect to be able to grant. (29 CFR §553.25)
4. Upon termination of employment, an employee must be paid for unused compensatory time at a rate not less than the average regular rate received by the employee during the last 3 years of employment, or the final regular rate received by the employee, whichever is higher. (29 CFR §553.21 & .27)
5. The school district should keep a record of compensatory time earned each workweek, compensatory time used each workweek, and the number of hours of compensatory time compensated in cash and the total amount and date paid, for each employee subject to compensatory time provisions. (29 CFR §553.50)

Suggested Audit Procedures:

- As part of payroll testing, determine if any employees worked in excess of 40 hours in a workweek during the audit period. If so, verify that either cash overtime at the rate of 1 ½ times the employee's regular rate was paid or that compensatory time was accrued for that employee.

(Note to auditor: For additional information regarding the FLSA see the US Department of Labor and Industry's Web site at <http://www.dol.gov/esa/whd/flsa/> .)

- Verify that the school district maintains the necessary records for compensatory time. Based on a review of these records, verify that compensatory time is not accrued in excess of the limitations noted above. If compensatory time accrued exceeds these limitations, verify that the excess amount is paid in cash.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 15 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

GROUP INSURANCE

15. Compliance Requirements:

- Upon approval by two-thirds vote of officers and employees, the school district shall enter into group hospitalization, medical, health, including long-term disability, accident or group life insurance contracts or plans for the benefit of the officers and employees and their dependents. (Section 2-18-702(1)(a), MCA)
(Note: For purposes of this compliance requirement, an employee includes a permanent part-time employee who is regularly scheduled to work 20 hours or more a week, a seasonal full-time employee who works for a continuous period of more than 6 months, a seasonal part-time employee who works 20 hours or more a week for a continuous period of more than 6 months a year, an elected official, and a temporary employee who works for a continuous period of more than 6 months a year or whose temporary status is defined through collective bargaining. (Section 2-18-701, MCA))
- The school district's premium contributions for each employee may exceed but may not be less than \$10 a month. (Sections 2-18-703(3))
- Unused employer contributions for any employee may be transferred to an account established for this purpose by a self-insured government and upon transfer may be used to offset losses occurring to the group or to increase the reserves of the group. (Section 2-18-703(5), MCA)
- Group insurance plans are not prohibited from providing greater or additional contributions for insurance benefits to employees with dependents than to employees with no or fewer dependents. (Sections 2-18-702(1)(a) & 2-18-703(6), MCA)

Suggested Audit Procedures:

- If a school district has entered into a group insurance plan for its employees, determine that only eligible employees, as defined above, are allowed to participate in the plan.
- Verify that the school district's premium contribution to the plan is at least \$10 a month per employee.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 16 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

VOLUNTARY EMPLOYEES' BENEFICIARY ASSOCIATION (VEBA)

16. Compliance Requirements:

(Note: The VEBA, which is centrally administered by the Montana Department of Administration, provides members with individual health care expense trust accounts to pay qualified health care expenses of members, their dependents, and their beneficiaries. Under the plan, employer contributions, investment earnings, and payments for qualified health care expenses are tax-exempt. A local government, however, is not prohibited from establishing a similar program as an alternative or in addition to participation in the State VEBA plan discussed here. For more information on VEBA see: <http://www.montanaveba.org/>.)

- As either initiated by the local government, or at the request of at least 25% of its employees, the local government may hold an election to determine whether all the employees, or a specified group of employees, will form an association for the purpose of participating in the plan. If a majority of employees vote to form an association, all current and subsequently-hired employees must become plan members. The local government shall enter into a contract with the Department of Administration, and shall operate the association in a manner prescribed by that Department. (Section 2-18-1310, MCA)
- Plan members shall annually designate how many hours, if any, of the member's sick leave will be automatically converted to an employer contribution to the member's account each pay period. A member may annually convert only sick leave hours in excess of 240 hours, and no more than the maximum prescribed by the local government. (Section 2-18-1311(1) & (2)(a), MCA)
- The amount of the employer contribution for hours converted must be equal to ¼ of the accumulated sick leave, and must be computed on the basis of the employee's salary or wage at the time of the conversion. A member may not later receive, as sick leave credit or as a lump-sum payment, amounts contributed to the member's account. (Section 2-18-1311 (3), MCA)
- When the member's employment is terminated, the member's entire unused sick leave balance must be automatically converted to an employer contribution to the member's account, and may not be paid as a lump sum under Section 2-18-618(6), MCA (See Compliance Requirement No. 8, above). (Section 2-18-1311 (2)(b), MCA)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 18 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued

17. Compliance Requirements - continued: State and Federal Tax Withholdings

- Although an employee may claim exemption from federal income tax withholding, there is no such provision for exemption from Montana state income tax withholding. If a federal exemption is claimed, wages for that employee are still subject to social security and Medicare taxes.
- The local government is required to remit its withholding payments to the State on a schedule (quarterly, monthly, or accelerated) determined by the State. The most common remittance schedules are quarterly or monthly.
- Payments to employees that are not subject to federal or state income tax withholding include:
 1. Employee business expense reimbursements, as long as each reimbursement is entered separately in the school district's records and there is documentation that the expenses were incurred while conducting business. Reimbursements must be based upon actual, receipted expenses, or on meal, lodging and mileage amounts allowed to State employees. **(Note: See SD-4 for compliance requirements related to travel expenses.)**
 2. Employer payments or contributions for employee benefit group plans, such as retirement, sickness or accident disability, medical, hospitalization or death.
 3. Employee contributions to qualifying annuity contracts, such as annuity plans or deferred compensation plans, Teachers Retirement System (TRS) or Public Employees Retirement Systems (PERS).
 4. Employee contributions to flexible spending accounts for medical and/or dependent care and health, dental and/or vision insurance premiums that exceed the employer's contribution.

(Note: Technically, these employee "contributions" are actually payments deducted from an employee's gross pay for cafeteria (aka Section 125) plans. Typically, the payroll records will show "gross wages", "Medicare wages", "Social Security wages", etc. to show the amount of applicable wages to which the tax rate is applied.)

Suggested Audit Procedures:

- As a part of payroll testing, verify that there is a current W-4 form on file for each selected employee.
- For selected individuals, verify that payments either are, or are not, subject to withholding as described above.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 19 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued

Suggested Audit Procedures - continued: **State and Federal Tax Withholdings**

- If considered necessary, verify that withholdings for selected individuals agree to withholdings in the State Withholding Tax Tables that coincide with the marital status and allowances designated on the individual's Form W-4.
- If deemed necessary, test federal withholdings for compliance with Federal laws and regulations, including those specified in "Publication 15, Circular E, Employer's Tax Guide" produced by the Internal Revenue Service.

18. Compliance Requirements: **State Unemployment Insurance**
(Note: Compliance Requirements are from the "Employer's Tax Guide" produced by the Montana Department of Revenue)

- All local governments must be covered by State unemployment insurance. **(Note: Local governments are exempt from Federal unemployment insurance.)** The employer pays unemployment insurance contributions, and no part of the contributions may be withheld from an employee's wages. Local governments may choose coverage either as a "reimbursable employer", or may choose to make tax payments based on the experience rating system where their tax rate is applied to total wages. Whatever option is elected, the local government must also pay a .05% (.0005) Administrative Fund Tax on total wages paid each quarter.
(Section 39-51-1103, & 404, MCA)
 1. Reimbursable Employer – the local government is required to submit quarterly wage reports on total wages paid each quarter. The State Department of Labor and Industry then notifies the local government monthly of the benefits charged to the local government's account. These charges may be paid monthly or the entire quarterly charges may be paid within thirty days following the end of the quarter.
 2. Experience Rating System – The local government is required to pay taxes, at a rate calculated by the State, on the wages of each employee up to and including the taxable wage base for that year. The taxable wage base is listed in the upper left hand corner of the quarterly report form. (The taxable wage base for calendar year 2001 was, \$18,200; 2002 was \$18,900; 2003 was \$19,700; 2004 was \$20,300; 2005 was \$21,000; and 2006 was \$21,600.) Once the individual employee's wages reach the taxable wage base for the year, the employee's quarterly wages are still reported, but taxes are no longer paid on them.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 20 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS – continued:

18. Compliance Requirements - continued: State Unemployment Insurance

- The following are considered to be wages for purposes of unemployment insurance:
 1. Holiday pay, vacation pay, sick leave payments, overtime cash payments, severance or continuation pay, and back pay.
 2. Payments deducted from an employee's gross pay for cafeteria plans, deferred compensation plans, and sickness, disability, medical or hospital insurance plans.

Also, state and federal income tax withholdings and social security taxes do not reduce reportable wages.
(Section 39-51-201, MCA)

- The following are not considered to be wages for purposes of unemployment insurance:
 1. Contributions made by the employer for retirement, sickness or accident disability, medical, hospitalization or death employee benefit plans, if employees may not elect to receive cash instead of coverage. The plan must be one established for all employees or for a specific class of employees. Employer contributions for all other employee benefit plans are reportable as wages.
 2. Payments made to reimburse an employee for business expenses, if certain rules are followed. Each reimbursement must be entered separately in the employer's records, and there must be documentation that the expense was incurred while conducting business. The reimbursement must be based upon actual, receipted expenses, or upon the per-diem and mileage amounts allowed to State employees.
(Note: See SD-4 for compliance requirements related to travel expenses.)
(Section 39-51-201, MCA)

Suggested Audit Procedure:

- Review selected quarterly unemployment payroll reports to verify that all wages, as defined above, are included. Also, verify that employer contributions for employee benefit plans described above, employee business expense reimbursements, and salaries and wages of elected public officials are not included in the payroll reports.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 21 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued

19. Compliance Requirements:

Workers' Compensation

- The Workers' Compensation Act of Montana, with limited exceptions, requires all employers to cover their full-time, part-time, seasonal, or occasional employees with workers' compensation insurance. All workers' compensation insurance premiums are to be paid by the employer. Employers may not deduct any part of the premiums from employees' pay. (Section 39-71-406, MCA)
- An employer has three options for coverage: Plan 1 - self insured, Plan 2 – private insurance companies, and Plan 3 – Montana State Fund. The premium that an employer pays is based on a percentage of the employees' payroll, which is in turn based on a class code rate and an experience modification factor. The payment schedule is spelled out in the individual employer's insurance policy. (Title 39, Chapter 71, Parts 21, 22 & 23)
- All elected and appointed paid public officers are considered to be employees for purposes of workers' compensation coverage. (Section 39-71-118(1)(a), MCA)
- Generally, a volunteer is not considered to be an employee for purposes of workers' compensation coverage. (Section 39-71-118(2)(c))

Suggested Audit Procedures:

- As part of payroll testing, verify that no part of the employer's insurance premium is paid through employee payroll deductions.
- Verify that all employees, including elected and appointed school district officials, are covered by workers' compensation insurance.

20. Compliance Requirements:

Social Security and Medicare

- Local government employees are covered by Social Security and Medicare in one of two ways.
 - a. One way is through a federal-state agreement called a Section 218 agreement (authorized under Section 218 of the Social Security Act). Those agreements should specify the Social Security and Medicare coverage for local government employees. There may be exclusions for certain groups of employees.
 - b. The other way is under the mandatory provisions of federal law. Employees hired (or rehired) after March 31, 1986, must have Medicare coverage unless the law specifically excludes them. Employees in continuous employment before April 1, 1986, who are members of a public retirement system, may be covered for Medicare under a Section 218 agreement at the state's option.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 22 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued

20. Compliance Requirements - continued:

Social Security and Medicare

- Another law (effective July 2, 1991) requires state and local government employees not covered by a Section 218 agreement or a public retirement system to be covered by Social Security and Medicare, unless the law specifically excludes them.

(Note: More detailed information on Social Security and Medicare coverage for local government employees can be obtained from the following:

Social Security Administration	State Social Security Administrator
10 West 15th Street, Suite 1600	Public Employees Retirement Division
Helena, MT 59626	100 North Park, Suite 220
	P.O. Box 200131
Internal Revenue Service	Helena, MT 59620-0131
10 West 15th Street, Suite 2300	(406) 444-3154
Helena, MT 59626	

A publication entitled “Federal-State Reference Guide - Social Security Coverage and FICA Reporting by State and Local Government Employers” can be obtained by calling the IRS at 1-800-829-3676. In addition, the Internal Revenue Code, Social Security Act and related regulations, rulings and case law should be consulted as necessary. Section 218 agreements for a particular local government should be on file with the local government. In addition, a copy should be available from the State Social Security Administrator. As noted above, the Public Employees Retirement Division acts as Montana’s State Social Security Administrator.

- The employer and employee tax rates for Social Security are both 6.2% (12.4% total). The employer and employee tax rates for Medicare are both 1.45% (2.9% total). The wage base limit (i.e., the maximum wage that is subject to tax) for Social Security changes periodically. For 2003, the limit was \$87,000, and for 2004, the limit is \$87,900; for 2005 the limit was \$90,000; and for 2006 the limit was \$94,200. There is no wage base limit for Medicare. Also, payments deducted from an employee’s gross pay for cafeteria plans (aka, Section 125 plans) are not subject to social security and Medicare withholdings.

Suggested Audit Procedures:

- Determine whether the local government entity is covered by a Section 218 agreement.
- If it is, obtain and review a copy of the Section 218 agreement.
- As part of payroll testing, determine that employee coverage for Social Security and Medicare is in accordance with the entity’s Section 218 agreement.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 23 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PAYROLL WITHHOLDINGS AND EMPLOYER PAYMENTS - continued

Suggested Audit Procedures - continued:

Social Security and Medicare

- If the entity is not covered by a Section 218 agreement, determine that employee coverage for Social Security and Medicare is in accordance with applicable federal laws and regulations.
- For employees covered by Social Security and/or Medicare under either a Section 218 agreement or federal laws and regulations, test to determine that employee withholdings and employer contributions are in accordance with applicable federal laws and regulations. For selected individuals whose wages exceed the Social Security wage base limit, verify that no Social Security tax was withheld for the portion of the wages that exceeded the wage base limit. Also, verify that Medicare tax was withheld on the portion of the wages that exceeded the Social Security wage base limit.

IRS FORM 1099-MISC

21. Compliance Requirement:

- The entity must report on a Federal Information Return, Form 1099-MISC, all payments of \$600 or more which the entity makes during a calendar year to anyone, other than a corporation or tax-exempt organization, who is not an employee. (U.S. Internal Revenue Service Codes)

(Note: The following are some examples of payments to be reported on Form 1099-MISC. For a complete list, contact the IRS:

- ◆ Professional service fees, such as fees to attorneys (including corporations), accountants, architects, contractors, subcontractors, etc.
- ◆ Payments by attorneys to witnesses or experts in legal adjudication.)

Suggested Audit Procedure:

- As part of expenditure testing, determine that the entity filed a Form 1099-MISC for each payee who was not a corporation or tax-exempt organization to which the entity paid \$600 or more for contracted services during the calendar year.

IMMIGRATION AND NATURALIZATION SERVICE (INS) FORM I-9

22. Compliance Requirement:

- An employer is responsible for ensuring that a completed Form I-9 is retained on file for all employees hired after November 6, 1986. Section 1 of the Form is to be completed and signed by the employee at the time of hire. The employer is required to complete Section 2 by examining evidence of identity and employment eligibility within three business days of the date employment begins.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 24 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

IMMIGRATION AND NATURALIZATION SERVICE (INS) FORM I-9 - continued

Suggested Audit Procedure:

- Verify that the school district has a completed Form I-9 on file for any employee hired after November 6, 1986.

RECORDKEEPING

23. Compliance Requirement:

- OMB Circular A-87, the OPI Federal and State Grant Handbook, and Section 39-3-401, MCA, require employers to keep time and effort records. The School Accounting Manual Section 5-1700 also suggests that the following other records be kept:
 - ◆ Monthly payroll recap
 - ◆ Monthly Tickler file
 - ◆ Payroll Manual/Notebook
 - ◆ Decedent's Designation to Receive Warrants

Suggested Audit Procedure:

- Determine if time and effort records were kept as required by federal and state laws and regulations. Also, check to see if other records were kept as suggested by the School Accounting Manual.

PROFESSIONAL STIPENDS

24. Compliance Requirement:

- A one-time stipend of \$3,000 must be provided to each teacher who obtains certification from the national board for professional teaching standards if the teacher meets the requirements of Section 20-4-134, MCA. A teacher is eligible for the stipend in the school year beginning July 1 after the teacher obtains certification from the national board for professional teaching standards. By March 1, the Superintendent of Public Instruction shall distribute stipend payments to each eligible teacher. **The obligation for funding the professional stipend is an obligation of the state.** This section may not be construed to require a school district to provide a stipend to a qualifying teacher without a payment from the state to the district. If the funding for professional stipends is less than the total amount for which Montana teachers qualify, the Superintendent of Public Instruction shall prorate the funding to the districts in a manner that provides the same amount of stipend to each qualifying teacher. (Section 20-4-134, MCA)

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 25 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

PROFESSIONAL STIPENDS - continued

Suggested Audit Procedure:

- Determine if any teacher who obtains certification from the national board for professional teaching standards received a one-time stipend of \$3,000. If so, verify that the payment did not become an obligation of the district.

EMPLOYEE PAY STUB

25. Compliance Requirement:

- All employers in this state when making payment to employees for salaries or wages shall, upon making such payment, give to the employee an itemized statement setting forth moneys deducted because of state and federal income taxes, social security, or any other deductions together with the amount of each deduction. Where no deduction is made, the employer shall give to the employee a statement that the payment does not include any such deductions. (Section 39-3-101, MCA)

Suggested Audit Procedure:

- Through inquiry and observation determine if employee pay stubs include the information as required by Section 39-3-301, MCA.

NEW HIRE REPORTING

(Note: The New Hire reporting program, legislated by both the federal government and the State in 1997, assists in the State's efforts to locate noncustodial parents. Information reported is used to collect child support and reduce public assistance costs.

For more information, see:

<http://www.acf.hhs.gov/programs/cse/newhire/employer/publication/nhreporting/definition.htm>

and for a listing of state new hire reporting contacts see:

http://www.acf.hhs.gov/programs/cse/newhire/employer/contacts/nh_matrix.htm - MT)

26. Compliance Requirements:

- Federal law states that an "employer" for New Hire reporting purposes is the same as for Federal income tax purposes (as defined by Section 3401(d) of the Internal Revenue Code of 1986) and includes any governmental entity or labor organization. At a minimum, in any case where an employer is required to have an employee complete a W-4 form, the employer must meet the New Hire reporting requirements.
- The penalty set by Federal law for failing to comply with the New Hire reporting requirements is set at \$25 per newly hired employee.

PROGRAM/SUBJECT: School Districts - Payroll and Employee Benefits	REF: SD-5
	PAGE: 26 of 26

I. COMPLIANCE REQUIREMENTS AND SUGGESTED AUDIT PROCEDURES:

NEW HIRE REPORTING – continued

26. Compliance Requirements - continued:

- Every Montana employer is required to report a minimal amount of information on each new employee hired or rehired on or after October 1, 1997. This information includes: Employer: *Name, Address, Federal Employer Identification Number;* Employee: *Name, Address, Social Security #, Date of Hire.*
- Reports must be submitted within 20 days of the date the employee is hired or rehired. For more information see the Department of Revenue's Web site at <http://mt.gov/revenue/formsandresources/forms/newhirereporting.pdf> (Section 40-5-922, MCA)

Suggested Audit Procedure:

- Determine if the school district hired any employees during the audit period. If so, verify the school district remitted the appropriate information to the State Department of Revenue within 20 days of the new employee's hiring date.